Directorate of
Intelligence

~~Secret~~

25X1

file Copy
do not remove

5 art.
32 brfs

International Economic & Energy Weekly

25X1

17 May 1985

~~Secret~~

DI IEEW 85-020
17 May 1985

Copy 680

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

25X1

Page Denied

[redacted]

25X1

International Economic & Energy Weekly [redacted]

25X1

17 May 1985

25X1

25X1

[redacted]

Comments and queries regarding this publication are welcome. They may be directed to [redacted] *Directorate of Intelligence,* [redacted]

25X1

25X1

 25X1

Secret

International Economic & Energy Weekly 25X1

Synopsis

---

1 **Perspective—Prospects for the US-USSR Joint Commercial Commission Meeting** 25X1

The US-USSR Joint Commercial Commission (JCC) meeting scheduled for 20-21 May—the first formal government-to-government trade talks since 1978—will be more important politically than in economic terms. The Soviets view increased trade with the United States as one step among many now being undertaken to normalize bilateral relations. 25X1

---

3 **US-Soviet Trade: No Major Increase Likely** 25X1

The US-USSR Joint Commercial Commission (JCC) meeting next week does not hold the promise of a large-scale revival of bilateral trade. 25X1

---

7 **Economic Policy Under Gorbachev** 25X1

Since taking office two months ago, General Secretary Gorbachev has expressed dissatisfaction with the performance of the Soviet economy. His economic proposals, however, are vague and, on balance, we do not believe that these programs will lead to a significant improvement in Soviet economic performance. 25X1

---

11 **Ecuador: Free Market Reforms** 25X1

Since assuming office last August, President Febres-Cordero has turned to market forces to stimulate entrepreneurial activity. Although we believe economic recovery will probably continue along with improvements in the external accounts, efforts to extend the reform program may be thwarted by political feuding with the congress, higher international interest rates, and likely reductions in world oil prices. 25X1

---

15 **Pakistan: Economy Becoming a Political Issue** 25X1

Despite sustained economic growth, Pakistan is suffering from two years of agricultural problems, severe power shortages, and a deteriorating foreign payments position, which could cause political difficulties for President Zia. 25X1

---

19 **LDC Cocoa Producers: Coping With a Changing Market** 25X1

While tight world supplies and the strong US dollar have helped boost cocoa earnings recently, world demand is growing slowly and a return of surpluses and lower prices is expected over the longer term. Ghana and Nigeria are losing market shares as new competitors, Brazil and Malaysia, and a traditional exporter, the Ivory Coast, expand production. 25X1

International Economic & Energy Weekly [redacted]

25X1

17 May 1985

Perspective

Prospects for the US-USSR Joint Commercial Commission Meeting [redacted]

25X1

The US-USSR Joint Commercial Commission (JCC) meeting scheduled for 20-21 May—the first formal government-to-government trade talks since 1978—will be more important politically than in economic terms. The Soviets view increased trade with the United States as one step among many now being undertaken to normalize bilateral relations. As such, the Soviets appear to consider JCC talks as part of an ongoing process to encourage trade, build a business constituency to represent Soviet interests in both the commercial and political spheres, and improve Moscow's image in the eyes of the US public to lessen support for US policies and actions Moscow views as anti-Soviet. [redacted] 25X1

Moscow probably expects the United States to show some flexibility on trade matters and particularly hopes to gain access to selected technologies and equipment. Although generally disappointed with the contributions of Western technology to their overall economy, the Soviets continue to seek US technology and goods. We do not believe the Soviets expect substantial progress on the key issues they intend to raise at the meeting—notably export control lists and restrictive trade practices—but they will look for, and probably will publicly acclaim, any positive movement. They would, in fact, probably proclaim the JCC a success if progress were made on even some of the relatively minor issues—the ban on Soviet fur skins, for example, or reinstatement of Aeroflot landing rights. [redacted] 25X1

Moscow apparently thinks that any evidence of improved US-Soviet relations will contribute to the American public's skepticism about US defense programs and about administration resistance to Soviet initiatives abroad. The Soviets may also hope that prospects of increased trade could lead US businessmen to urge US policymakers to adopt more conciliatory positions on arms control or, similarly, to avoid policy decisions that Moscow views as hostile. [redacted] 25X1

If the JCC is successful, we believe Moscow will take additional steps to promote trade. The USSR will likely buy some food-processing and consumer goods manufacturing equipment, and possibly several turnkey plants. Orders may, in fact, have been delayed to coincide with or closely follow the JCC session. Nevertheless, economic realities will continue to constrain rapid growth in bilateral trade over the next several years:

- Moscow has developed alternative suppliers in Eastern and Western Europe to reduce dependence on US goods; their proximity to the USSR, moreover, gives them a marked advantage in raw materials trade and the compensation deals that the Soviets favor.

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

- Except for grain, US sales will be hampered because Soviet hard currency earnings will be down, at least through 1990—largely the result of a slowdown in oil exports. Even if funds were freely available, Moscow would continue to be selective because of past problems in absorbing Western technology.

- Efforts to interest US businessmen in Soviet exports will probably continue to be unsuccessful. 25X1

25X1

US-Soviet Trade: No Major Increase Likely [1] [redacted]

25X1

The US-USSR Joint Commercial Commission (JCC) meeting next week—the first since December 1978—does not hold the promise of a large-scale revival of bilateral trade. Although the USSR has taken a somewhat more positive attitude toward US-Soviet trade since the meeting of the JCC working group in January, many contentious issues remain unresolved. While Moscow realizes that resolution of major issues is unlikely, the Soviets would probably proclaim the session a success if progress were made on even some peripheral issues such as reinstatement of Aeroflot landing rights. Moscow could interpret even such limited gains as a sign of the administration's interest in moving toward an overall normalization of relations. [redacted]

Renewed Interest in Trade With the United States

Following nearly a decade in which US-Soviet economic relations have steadily deteriorated, Soviet foreign trade officials and industrial managers have recently indicated a renewed interest in expanding trade relations. Although US firms so far have been largely frozen out of the bidding as primary contractors for major projects during the 12th Five-Year Plan (1986-90), Soviet officials in December 1984 held out prospects that US firms might play a greater role than they had in the 11th Five-Year Plan. They are, moreover, pressing for rapid resolution of some of the outstanding trade issues so that Soviet enterprises will have time to incorporate US imports in their plan calculations. [redacted]

During talks held in early December 1984, a high-ranking Soviet official discussed 15 potential areas of cooperation—including energy projects and consumer goods plants—with visiting US businessmen. In January the Soviet delegation to the US-USSR Working Group of Experts meeting in Moscow

[redacted]

The Role of the JCC

The Soviet Union generally insists on the establishment of joint (or mixed) commercial commissions to regulate its bilateral trade relations with Western countries. Composed of midlevel and high-level representatives of the respective governments, the delegations to these commissions generally are able to sign long-term trade agreements or to commit their governments to the promotion of bilateral trade through legislation, financing, or other means. For the most part, these commissions meet on a regular basis—at least once a year and often more frequently. [redacted]

25X1

25X1

The US-USSR Joint Commercial Commission (JCC) has not met for six years—since the invasion of Afghanistan—and the Soviets have expressed their unhappiness over this interruption in government-to-government contact. Soviet officials—who think of the JCC as the nonagricultural equivalent of the US-USSR Grain Consultations—cite the absence of such a forum as evidence of the US propensity to link economic and noneconomic issues. Even when the JCC was meeting regularly, however, the USSR complained that the United States did not attach sufficient importance to it. [redacted]

25X1

The US-USSR Trade and Economic Council, a private organization, has maintained commercial ties between the two countries in the intervening period, but the Soviets have found it to be an unsatisfactory alternative. The Soviets look at trade with a much longer perspective—thinking in terms of five- and 10-year plans—than do US businessmen, who generally come to the negotiating table ready to discuss a particular sale or contract. Moreover, US businessmen cannot negotiate most of the policy issues involved in overall US-Soviet commercial relations. [redacted]

25X1

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

seemed willing to compromise on solutions to longstanding problems. A number of small contracts were awarded to US firms in late January and early February, and Soviet foreign trade officials have resumed participating in joint commercial seminars held at the US commercial office in Moscow.

This turnabout in Soviet attitudes roughly coincides with the reversal last fall in Moscow's yearlong refusal to return to nuclear arms control talks with the United States. Some Soviet statements to US businessmen strongly suggest that the two issues are closely linked in the minds of the Soviet leadership, implying that the change in trade policy was prompted in part by the hope that US businessmen could be used to influence the US negotiating position. Party General Secretary Gorbachev recently indicated that progress in bilateral ties would depend on East-West security issues.

Prospects for Increased Bilateral Trade

Even if the political atmosphere continues to improve, three major impediments to a sharp increase in bilateral trade remain.

Changing Trade Patterns and Attitudes. Partly in response to US sanctions, Moscow developed new trade relationships with alternative suppliers that reduced the Soviet need for US goods. In particular, trade with Eastern Europe has increased at the expense of trade with the West. Although East European equipment is generally less sophisticated than that available in the West, in many instances it is still better than comparable Soviet machinery. The Soviets also have diverted some of the trade formerly conducted with the United States toward Western Europe and Japan whom they correctly perceive as being less strict in applying export controls than the United States.

Longstanding Issues. Trade controls and the denial of most-favored-nation status (MFN) are continuing impediments to bilateral trade. Moscow claims that the export controls imposed by the Coordinating Committee for Multilateral Export Control (COCOM) are unpredictable, do not follow common criteria, and often change without warning. Moreover, the United States maintains more extensive control over US-origin technology. 25X1

The lack of MFN status has been a constant irritant to US-Soviet commercial contacts since the early 1970s and is particularly galling to Moscow because it has been awarded to other Communist countries, such as Poland and China. Symbolically, it is important to Moscow as an acknowledgment that the United States finally considers the USSR an equal trading partner. Economically, it would mean lower tariffs on some items as well as access to Eximbank credits. 25X1 25X1

Shifts in Basic Economic Factors. Since the mid-1970s, Soviet disappointment over the contribution of Western technology to industrial productivity has cooled Moscow's enthusiasm for increased bilateral trade. The expected benefits did not materialize, partly because of problems in assimilating foreign equipment. As a result, Moscow has become more selective in its legal acquisition of Western technologies, seeking equipment that will, first, increase defense industry capabilities and, second, break bottlenecks in the energy and agro-industrial sectors. 25X1 25X1 25X1

Finally, the USSR's hard currency import capacity will be limited by declining oil export volume and lower world oil prices. Unless Moscow revises its cautious borrowing policy, this could well force the USSR to reduce the volume of imports from hard currency countries at least through 1990. Although grain trade may be protected, this factor will seriously limit a revival of Soviet nongrain purchases from the United States. 25X1

Outlook for Upcoming Negotiations

25X1

At the JCC meetings the Soviets will probably be looking for some progress on contentious trade issues as an affirmation of US willingness to normalize US-Soviet relations. They probably are

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

USSR: Trends in Trade With the United States *Million US $*

	1971-75 *(annual average)*	1976-80 *(annual average)*	1981	1982	1983
Soviet imports	**972**	**2,523**	**2,310**	**2,859**	**2,120**
Agricultural products	590	1,745	1,614	2,146	1,475
Grain	572	1,476	1,533	1,931	1,177
Raw materials	27	30	26	5	11
Manufactures	355	748	670	708	634
Machinery	239	542	279	234	194
Chemicals	39	62	148	257	234
Soviet exports	**153**	**355**	**255**	**214**	**446**
Agricultural products	2	2	3	NEGL	NEGL
Raw materials	44	139	5	1	111
Manufactures	107	214	247	213	335
Chemicals	15	45	89	96	140

25X1

USSR: Hard Currency Machinery and Equipment Orders

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Total *(million US $)*	**5,866**	**3,783**	**2,818**	**2,674**	**2,641**	**6,830**	**3,774**	**2,237**	**1,091**
United States *(million US $)*	785	311	560	277	232	267	86	27	71
US share *(percent)*	13	8	20	10	9	4	2	1	7
Energy equipment	1,700	323	825	190	400	4,320	1,325	835	67
United States *(million US $)*	321	97	368	35	21	54	1	1	1
US share *(percent)*	19	30	45	18	5	1	NEGL	NEGL	1
Nonenergy equipment	4,166	3,460	1,993	2,484	2,241	2,510	2,449	1,402	1,024
United States *(million US $)*	464	214	192	242	211	213	85	21	70
US share *(percent)*	11	6	10	10	9	8	3	1	7

25X1

encouraged by recent actions such as the US Government's failure to ban imports of selected Soviet goods that allegedly are manufactured with forced labor, and the easing of certain COCOM restrictions—on personal computers, for example. Moscow may also raise such issues as the US ban on imports of Soviet furs, the barrier to imports of Soviet nickel, the 14-day advance notification requirement for Soviet port calls, and US refusal to recertify Aeroflot flights into this country. 25X1

Moscow understands that more serious trade issues—MFN, a major reduction in trade controls, or US guarantees of contract sanctity—will probably not be fully resolved soon. But Soviet negotiators will be looking for some evidence of US willingness to discuss these issues and will be ready to publicly trumpet even slight progress. 25X1

If any progress is made on these issues, there should be some increase from the current low level of US-Soviet trade. The Soviets still need large-scale imports of Western technology and manufactured goods and continue to hope for political benefits from trade ties with the United States. 25X1

It is extremely unlikely, however, that bilateral nonagricultural trade will return to the levels of the 1970s. The shifts in trade patterns that Moscow initiated and its determination not to be vulnerable to US sanctions are major impediments. With the exception of a few important areas, such as state-of-the-art offshore drilling equipment, the USSR can go elsewhere for nearly equivalent machinery and technology and have these purchases financed by government-backed credits. 25X1

25X1

Economic Policy Under Gorbachev [redacted]

25X1

Since taking office two months ago, General Secretary Gorbachev has expressed dissatisfaction with the performance of the Soviet economy. He has called for a return to rapid growth largely through "revolutionary" change based on scientific and technological innovation. His economic proposals, however, are vague and strikingly similar to the economic prescriptions of his predecessors, particularly Yuri Andropov. On balance, we do not believe that these programs will lead to a significant improvement in Soviet economic performance. [redacted]

Recent Economic Performance

Gorbachev's advent to power has coincided with a particularly disappointing performance by the Soviet economy thus far in 1985. For example, industrial production, which had risen by nearly 4 percent in both 1983 and 1984, increased by only 1 percent in January-March compared with the same period last year. [redacted]

The slowdown in industrial growth probably reflects:

- Severe winter snarls in transportation that caused delays in delivering timber, construction materials, and ores.
- Diversion of energy from industry to meet residential heating requirements.
- Underuse of plant, equipment, and labor because of supply bottlenecks and low inventories.
- Fewer working days than in the first quarter of 1984. [redacted]

Personnel Moves

Although acknowledging the role of harsh weather, Gorbachev attributes the subpar performance largely to gross waste and inefficiency, which, in turn, he ties to "complacency" and "irresponsibility" on the part of workers and managers alike. Consequently, he has made important changes in top-level positions that may facilitate the implementation of his economic agenda. He has already named three allies as voting members of the Politburo, probably giving him a working majority on most issues. The naming of Nikolay Ryzhkov and Yegor Ligachev to the Politburo is particularly significant and should help him overcome the resistance to change on the part of old-guard economic officials. In addition, he has appointed new ministers for oil, gas, and electric power and eight new regional party secretaries. [redacted] 25X1

Gorbachev's Economic Program

25X1

Gorbachev has made clear—mainly through his speech to the Central Committee in late April—that he is aiming for more rapid economic growth, principally through application of advanced science and technology. He has also proclaimed such general—and noncontroversial—goals as greater efficiency, elimination of extravagance and waste, and high-quality output. 25X1 Gorbachev and his team, however, have been singularly short on specifics. He has disclosed virtually no quantitative targets, although a planning official indicated to a Western visitor that the 12th Five-Year Plan (1986-90) will call for national income and industrial production to grow at about 4 percent a year.[1] These are ambitious targets under the best of circumstances, if only because the tightness of the labor supply will continue through the end of the 1980s and the difficulties in exploiting natural resources will 25X1 mount for the foreseeable future. [redacted] 25X1

The most concrete element in Gorbachev's plans for the Soviet economy is a projected reequipping of Soviet productive facilities with up-to-date machinery. This suggests that Gorbachev intends to

[1] Gross national product and industrial production grew at average annual rates of about 2.5 and 3.0 percent, respectively, in 1981-8 25X1 [redacted]

broaden the USSR's investment policy of the past several years, which has emphasized increasing the share of machinery in fixed capital investment and renovating existing facilities instead of building new ones. To carry out the reequipping program, the USSR—according to Gorbachev's April speech to the Central Committee—will raise the growth rate of machinery production one and a half to two times above the present rate. The machine-building sector—which manufactures consumer durables, industrial machinery, and military equipment—expanded 5.5 percent last year and has grown at an average rate of about 4.5 percent since 1980.

Gorbachev also has indicated that he will seek to improve the economic system by more efficient and vigorous implementation of programs initiated or expanded in the past three years. In particular, he is urging:

- Revival of the discipline campaign, which had lost steam under Chernenko.
- Linking workers' earnings to their output, through such means as greater differentiation of wages and more use of contract brigades—small groups of workers whose earnings depend on fulfillment of contractual obligations to management.
- Greater operational independence for enterprises. This would be implemented primarily by expanding the economic experiment begun in January 1984 that gives enterprises somewhat greater freedom to allocate funds at their disposal and makes fulfillment of contractual sales obligations the prime indicator for evaluating them

Not surprisingly, Gorbachev has endorsed Brezhnev's 1982 food program of which he was a primary architect. In this connection, he called for increasing the authority of the regional agricultural production associations, which are assigned a key role in coordinating farm activities with those of enterprises that provide agricultural inputs or process farm output. In the same vein, Gorbachev assigned top priority to modernizing the food-processing sector.

Gorbachev also is stressing the need to curtail the activities and powers of the ministries, which he has branded as principal sources of economic obstructionism. In addition, he has revived proposals for improving management by introducing training programs that emphasize problem solving, simulation, and game theory. 25X1

Prospects That Gorbachev Can Revitalize the Economy

Overall, Gorbachev's proposals are in keeping with 25X1
the conservative approach of tinkering with the system—not drastically altering it—characteristic of previous regimes. The Gorbachev program contains nothing radical—such as sharply reducing the role of central planning, allowing a greater role for market forces in determining prices and allocating resources, permitting bankruptcies and unemployment, or substantially enlarging legal private-sector activity. 25X1

The outlook for the critically important modernization program seems highly problematical at best. Successful implementation would require accompanying measures that would encourage innovation in machinery manufacturing heretofore lacking. Furthermore, accelerated growth in machinery production would require stepped-up investment in machinery manufacturing capacity. If—as planned—agriculture and energy retain their already-large share of investment, other critical sectors might be further squeezed, creating new bottlenecks in the economy. Allocating more investment to the machinery sector also could divert resources from 25X1
consumption and defense to a degree the regime considered unacceptable. 25X1

The impact of Gorbachev's recommended changes in the way the economic system operates is also uncertain. In the past, some seemingly marginal steps have had considerable impact, at least for a while. Andropov's discipline campaign, for example, evidently contributed to the acceleration in

25X1

growth of GNP in 1983 and in industrial production in 1983-84, mainly by increasing the number of hours actually worked. On the other hand, the overall record of piecemeal reforms is not encouraging because of their failure to attack basic causes of inefficiency. For instance, numerous modifications of the system for evaluating performance of enterprises have turned out unsatisfactorily—primarily because success indicators invite behavior by enterprise managers that runs contrary to the goals of the planners. [redacted] 25X1

We do not believe that Gorbachev's program will significantly improve Soviet economic performance. As Gorbachev acquires more political clout, he could opt for a more radical approach. In our judgment, however, this seems unlikely. Gorbachev is a product of the Soviet system and has been well rewarded by it. Furthermore, even if he favored a drastic change in the system, Gorbachev would encounter pervasive resistance from vested interests in all strata of Soviet society. The top leadership sees decentralization as a threat to its power while lower-level economic managers also look favorably on the status quo, because they have learned to manipulate it to their advantage. Workers also may take a jaundiced view of changes that might, for example, jeopardize job security. [redacted] 25X1

[redacted] 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

Ecuador: Free Market Reforms

25X1

Since assuming office last August, President Febres-Cordero has turned to market forces to stimulate entrepreneurial activity and revive the economy. His administration has made some politically difficult economic and financial moves that have already paid handsome dividends. We believe that, if these policies are successful, they could serve as a model for other South American debtors. Although we believe economic recovery will probably continue along with improvements in the external accounts, efforts to extend the reform program may be thwarted by political feuding with the congress, higher international interest rates, and likely reductions in world oil prices.

Economic Reforms . . .

Febres-Cordero has implemented free market reforms to revitalize the economy, raise living standards, and strengthen economic ties with the West. Domestically, he has raised interest rates toward market levels to stimulate domestic savings and has decontrolled some agricultural and fuel prices to spur increased production. He has also ordered cuts in subsidies, improved tax collection, limited wage increases, and reined in Central Bank lending. Externally, Febres-Cordero has strengthened export promotion by devaluing the sucre and phasing out multiple exchange rates in favor of the free market rate. Further, he has removed some tariffs and lifted the ban on most manufactured imports, thus dismantling some protectionist barriers that shield Ecuador's inefficient industries.

Since Febres-Cordero took office, Ecuador has welcomed foreign investors, becoming the first Andean country since 1971 to sign an insurance agreement with the US Overseas Private Investment Corporation. Oil exploration was opened to foreign bidders, and two contracts have been signed with US firms.

25X1

Quito is a force for moderation in the Cartagena Group, favoring individual country talks with creditors rather than confrontation through a debtors' cartel. The administration boasts that its economic strategies parallel IMF-recommended programs so closely that Ecuador would be in compliance even in the absence of a new standby agreement.

25X1

. . . Pay Dividends

25X1

Febres-Cordero's reform policies are boosting business confidence, according to press reports. Domestically, price decontrol is easing shortages of consumer goods, higher interest rates are diminishing speculative financial activity, and restrictive monetary policies have helped contain inflation. Following a 6.4-percent rise in the consumer price index in January reflecting the effects of price deregulation in late 1984, inflation was only 1.4 percent in February.

25X1

Ecuador's foreign payments position for 1985 has brightened considerably. The trade surplus increased in first quarter 1985 following export deregulation, even with the redirection of black-market imports back into official channels. Quito also recently reached a new $100 million standby agreement with the IMF and won the first multiyear Paris Club rescheduling. As a result of the IMF accord, commercial bankers agreed to a 12-year rescheduling of $4.6 billion of debts falling due during 1985-89. As part of this package, creditor banks also pledged $200 million in new medium-term loans and renewed a $750 million trade credit facility. As a result of the reschedulings, Ecuador's debt service burden will drop from a projected 60 percent of exports to 33 percent this year.

25X1

25X1

25X1

Ecuador: Economic Indicators

	1982	1983	1984 [a]	1985 [b]
	Percent			
GDP growth	1.4	−3.3	3.0	2.4
Agriculture	2.0	−13.5	11.7	5.2
Petroleum and mining	−3.9	24.5	10.3	4.5
Manufacturing	4.6	−5.6	−8.0	2.0
Consumer price growth	24	53	25	30
	Million US $			
Current account	−1,195	−104	−212	−208
Balance of trade	162	957	911	960
Exports, f.o.b.	2,343	2,365	2,491	2,710
Imports, f.o.b	2,181	1,408	1,580	1,750
Interest payments	767	693	801	808
Capital account	524	155	121	74
Net official international reserves (increase)	460	59	60	41
	Percent Share of GDP			
Public Share sector budget balance	−6.8	−1.0	0	3.4
Current account deficit	11.6	1.1	2.3	2.0

[a] Estimated.
[b] Projected.

25X1

Economic Challenges Ahead

The main challenge will be to continue the economic reforms needed to sustain growth and meet IMF targets in the face of uncertain external economic conditions. In the 1985 standby agreement, Ecuador has agreed to unify multitiered exchange rates and post a public-sector surplus, equal to 3.4 percent of GDP by holding down minimum wage hikes, further cutting subsidies, and sustaining a tight monetary program. According to the IMF letter of intent, these adjustments would reduce inflation to 20 percent at an annual rate and bring the foreign payments position into balance. Quito again devalued the sucre in March by shifting the exchange rate for oil exports and public-sector debt repayments to the free market rate.

Lower oil earnings—crude oil accounts for 60 percent of government revenues and 70 percent of export earnings—are a potential threat to the economic adjustment program. Ecuador's oil became overpriced in world markets at the end of 1984, and almost half of the state oil company's contracts were terminated by customers, forcing Quito to sell on the spot market at lower prices. By the end of February, however, the Ecuadoreans had lowered official prices in line with OPEC and again arranged contracts for most of their crude exports. Quito will face these same problems in the future unless it becomes more flexible in adjusting oil contracts. Nonetheless, such flexibility may not be enough to prevent a decline in oil revenues.

25X1

25X1

Febres-Cordero's free market reform policies will increasingly focus on boosting the efficiency of the private sector. Agriculture, which provides 40 percent of overall employment, needs infrastructure improvements and additional credits. Private construction has not yet picked up, and the low-cost housing program has hardly begun. Heavy subsidies are still provided for electricity, and domestic fuel prices are only 50 percent of world market levels.

Outlook for 1985

We believe that modest recovery will continue as increased agricultural, industrial, and petroleum production leads to real economic growth rate of about 2.4 percent. Growth will be uneven, however, because recent domestic interest rate hikes will dampen new construction and shortages of credit, and raw materials will constrain the textile industry. Consequently, we believe employment will fall short of official goals. Tight monetary and fiscal policies notwithstanding, devaluations, the removal of subsidies, price decontrol, and periodic increases in gasoline prices will probably keep inflation at about 30 percent.

Barring external shocks, we believe that the government will come close to its external payments goals. The $960 million trade surplus projected by the Central Bank will nearly match the deficit on services. The modest shortfall in the current account, in our judgment, will be covered by an increase in private direct investment and new loans from foreign bankers. Although total external debt will rise to about $7.6 billion, its share of GDP will decrease from 76 percent to 70 percent. Debt service, eased as a result of the rescheduling, should be met, and Quito is committed to clear debt payment arrearages when it receives its new money.

Economic Vulnerabilities

Ecuador's payments improvements continue to be vulnerable to changes in the price of oil and international interest rates. For example, if oil prices drop below $26 a barrel, Quito's export earnings will miss the targeted $1.9 billion, causing the current account deficit to be larger than projected. Similarly, if the three-month LIBOR rate rises above 10 percent, interest payments will exceed the planned level. Should such shocks occur, Ecuador would probably miss its IMF external targets and again fall behind on its interest payments. Moreover, oil export shortfalls would cut tax revenues and funds for public programs.

We remained concerned that the President's penchant for confronting and feuding with the congress may delay economic reforms. In March, Febres-Cordero defied both the congress and the Constitutional Guarantees Tribunal by implementing his minimum wage law by decree. Although no group has been able to challenge his actions successfully, opposition is polarizing, We believe that Febres-Cordero's ability to extend his economic reforms will be hindered—and perhaps blocked —by embittered legislative adversaries if he continues his uncompromising stance.

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Pakistan: Economy Becoming a Political Issue

Despite sustained economic growth, Pakistan is suffering from two years of agricultural problems, severe power shortages, and a decline in remittances from overseas workers, which could cause political difficulties for President Zia. Although faced with worsening budgetary and foreign exchange constraints, the government is not likely to undertake any time soon politically sensitive economic reforms necessary to improve the situation. Instead, Islamabad will look for help from Western aid donors to cope with its domestic economic difficulties and to shore up its deteriorating foreign payments situation. If sufficient aid is not forthcoming, the government will be faced with implementing politically unpalatable austerity measures.

Fragile Domestic Economy

Real economic growth slowed to 3.5 percent in FY 1984 after averaging 6 percent annually from FY 1978 to FY 1983. The relatively poor performance in 1984 primarily reflected bad weather, some mismanagement in the agricultural sector, and shortfalls in public- and private-sector financing. Lingering problems recently prompted the government to lower this year's GDP growth projection from a record 9.9 percent to 8.5 percent. We believe that even the new estimate is too high considering shortfalls in agriculture, insufficient power supplies, and budget constraints.

Pakistan's economy has been badly hurt by hot weather and a lack of rainfall that are likely to retard wheat production for the second consecutive year. The government probably will need to import at least 2 million tons of wheat over the next year at a cost of about $400 million. At the same time, drought has cut hydroelectric power production, forcing longer and more frequent power cuts than normal. Industry is particularly hard hit because agriculture is given priority on the release of water, and the loss of industrial production has been estimated at $3 million per day, according to US Embassy sources. Workers have been laid off and shortages of some manufactured goods, such as cement, are likely. 25X1

Additional water supplies from the spring snowmelt have temporarily alleviated the energy crisis, but the government policy of expanding the distribution of electricity to new customers could make the situation worse next year. US Embassy sources estimate that power cuts and additional unmet demand could reduce output by an average of $5 million daily by next year. 25X1

Budget Problems

25X1

Financial constraints have limited the government's room to maneuver. Islamabad is already spending about two-thirds of its current budget on food subsidies, defense, and debt servicing. Even with cutbacks for education and routine maintenance of the country's infrastructure, the budget deficit continues to grow and now totals 8 percent of GDP.

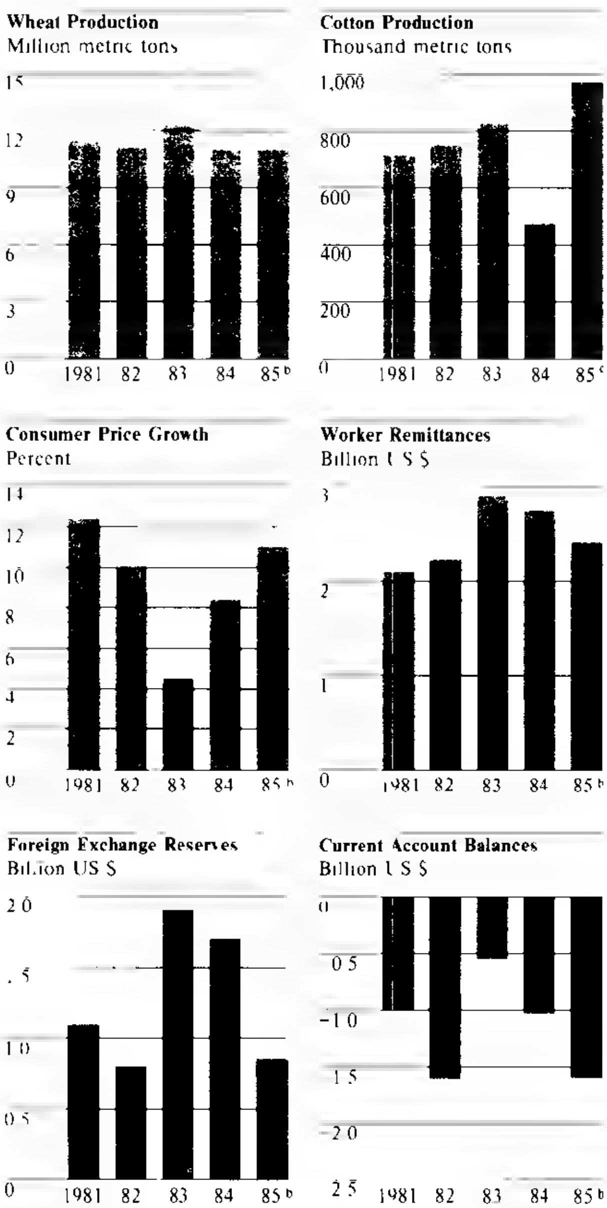
25X1

The government probably will find the deficit even more difficult to finance over the next year without expanding the money supply. Recently about half the deficit has been financed through small savings deposits in government-sponsored schemes that paid attractive rates of interest. Declining overseas worker remittances since 1983 and the move to interest-free "Islamic" banking probably will reduce the pool of savings available to the government. 25X1

25X1

Budget pressures are also forcing cuts in development programs. Development spending, which has been declining as a share of the total budget since Zia took power, fell in real terms last year. Moreover, foreign aid cannot be fully utilized because much of it is tied to projects that require some local

Pakistan: Economic Indicators, 1981-85[a]



[a] Data are for fiscal year ending 30 June.
[b] Projected.
[c] Estimated.

305686 5-85

funds, and there is a large backlog in the aid pipeline. Financing the budget deficits through private borrowing is soaking up investment funds that could be used by the private sector. With a slowdown in capital investment, Pakistan will continue to lose ground in its effort to provide jobs for a population growing at about 3 percent annually. 25X1

Pakistan has recently replaced its five-year development plan with a three-year "rolling" plan because of funding shortfalls. The targets for the new plan are about 13 percent below the part of the plan it replaces. Nonetheless, without government reform on taxes and subsidies, the US Embassy believes that Pakistan will not even be able to finance this less ambitious plan. 25X1

Foreign Exchange Constraints

Pakistan has drawn down its foreign exchange reserves to the point that it is losing flexibility to import the goods needed to alleviate domestic shortages. A growing trade deficit, declining worker remittances, and a rising debt service burden have reduced Pakistan's foreign exchange reserves to about $850 million, half the level at the end of the fiscal year last June:

- Exports have been hampered by the lingering effects of a poor cotton crop last year, stiff competition from other textile exporters, and low commodity prices. Import costs are up mostly because of price increases, and imports of wheat and electrical generating equipment will put even greater strains on the trade deficit.

- Worker remittances this year are about 13 percent below the same period in 1984 and probably will be about $500 million below the peak in 1983.

- Foreign debt service is likely to be about $1.2 billion this year including at least $100

25X1

Pakistan: Balance of Payments [a] *Million US $*

	1981	1982	1983	1984	1985 [b]
Current account balance	−991	−1,610	−554	−1,028	−1,600
Trade balance	−2,765	−3,450	−2,989	−3,334	−3,600
Exports (f.o.b.)	2,798	2,319	2,627	2,668	2,700
Imports (f.o.b.)	5,563	5,769	5,616	6,002	6,300
Net services and transfers	1,774	1,840	2,435	2,306	2,000
Worker remittances	2,095	2,224	2,886	2,737	2,400
Long-term capital (net)	581	746	1,276	882	1,000
Gross disbursements	956	1,092	1,301	1,234	1,400
Amortization	−516	−492	−386	−542	−500
Other	141	146	361	190	100
Other and short-term capital	772	629	390	−34	−250
Financial gap	**−362** [c]	**235**	**−1,112** [c]	**180**	**850**

[a] Fiscal year ending 30 June of the stated year.
[b] Projected.
[c] Surplus for the fiscal year.

25X1

million in interest payments on US Foreign Military Sales as well as repayment on other military debt.

Political Implications

The mounting economic problems are becoming a political issue. An exit poll taken during the assembly elections in February indicated that economic issues were the second most important concern of the voters after the implementation of an Islamic system. Economic problems are likely to be hotly debated when the new assembly meets later this month to discuss the budget.

Despite the need for major economic reforms, proposals put forth in this year's budget to improve the government's financial position are likely to be cautious. The new Minister of Finance and Planning, Mahbubul Haq, favors an overhaul of the tax system, a more productive use of savings, agricultural reforms, deregulation of industry, and decontrol of cooking oil and fertilizer prices. Any such proposals, however, are likely to face stiff resistance in the assembly because they threaten the interests of the strong bloc of conservatives and landlords. Moreover, the conservative former Finance Minister, Ghulan Ishaq Khan, retains considerable influence as chairman of the new senate. President Zia is unlikely to risk public unrest by supporting measures that will result in higher food prices. If a deteriorating economy becomes a major problem, Zia probably will blame the new assembly for inaction.

25X1

25X1

Pakistan will probably look for outside help in solving its economic problems. Islamabad has already asked the United States to help finance wheat imports and for concessional financing for future military purchases. In addition, it is likely to ask foreign aid donors to be more forthcoming with assistance that can be spent quickly and is not tied to projects that would draw on domestic financing.

25X1

25X1

25X1

LDC Cocoa Producers: Coping With a Changing Market

25X1

Government policies in many West African countries have led to neglect and mismanagement of their cocoa sectors and loss of market share for the $2-3 billion in annual world cocoa exports. For several of these countries, cocoa provides a large share of export earnings. Ghana and Nigeria have been hardest hit as new competitors, Brazil and Malaysia, and a traditional producer, the Ivory Coast, have aggressively expanded production, improved their marketing, and moved into higher-value-added cocoa products. Although tight world supplies and the strong US dollar have helped boost cocoa earnings recently, world demand is growing slowly, and a return of surpluses and lower prices is expected over the longer term. As a result, successful renegotiation of the International Cocoa Agreement could play a major role in stabilizing the market.

The Changing Cocoa Market

World cocoa consumption—currently estimated by trade sources at 1.7 million metric tons for 1985—will continue to grow at only 2 to 3 percent per annum through the end of the decade. The United States, West Germany, the Netherlands, the United Kingdom, and France account for about 40 percent of global consumption. Cocoa supplies have rebounded and are generally keeping pace with demand. For the 1984/85 (October/September) season, world cocoa bean production will be an estimated record 1.8 million tons, nearly 20 percent above the drought damaged 1983/84 harvest. In large part, this season's expected record crop reflects favorable growing conditions as well as the maturing of trees planted in the late 1970s in Brazil, Malaysia, and the Ivory Coast.[1] These plantings were spurred by high prices following the contraction of global production in the mid-1970s.

[1] The cocoa plant normally takes four to five years after planting to mature and bear fruit and from eight to 10 years to achieve maximum production.

The Ivory Coast, Brazil, and Malaysia have emerged as the major forces in the market:

- The Ivory Coast has captured the top spot in the world's cocoa economy by committing considerable resources to its cocoa sector and by providing farmers with remunerative prices. Production has doubled over the past 10 years and could reach 600,000 tons by 1990. Currently, Abidjan is actively cooperating with UK and US manufacturer associations on a project to upgrade Ivory Coast cocoa quality.

- Brazil is now the world's second-largest cocoa producer. Cocoa experts project that Brazilian production could exceed 500,000 tons by the end of the decade. Because of its free market policies and greater reliability of its cocoa grades, US cocoa buyers report that they are relying more on Brazil as a dependable volume supplier. 25X1

- Malaysia also has moved quickly into the ranks of the world's leading producers with a fourfold increase in output since the late 1970s. Although cocoa ranks a distant fourth among the country's agricultural export crops, the cocoa sector is seen as an integral part of the government's drive for economic development. Prospects are strong for a 200,000-ton crop by the early 1990s. Malaysia's cocoa industry has been plagued by serious disease and quality problems, and Malaysian beans are now sold at a substantial discount. Cocoa experts believe, however, that the government will take measures to improve quality. 25X1

Mismanagement by other West African cocoa-producing countries has played a major role in their loss of world market shares:

25X1

- Ghana, once the leading producer, has been in a state of general decline since the mid-1970s. Lack

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

Value of Cocoa Bean [a] Exports, by Selected Exporting Countries, Average 1980-82

	Million US $	Cocoa Bean Share of Country's Total Exports *(percent)*	Country Share of World Cocoa Bean Exports *(percent)*
World gross exports	**2,349.8**	NA	**100.0**
Americas			
Brazil	249.8	1.2	10.6
Dominican Republic	49.5	5.1	2.1
Ecuador	45.8	1.9	1.9
Africa			
Benin	11.6	26.9	0.5
Cameroon	160.3	13.7	6.8
Equatorial Guinea	14.8	42.9	0.6
Ghana	492.5	46.3	21.0
Ivory Coast	674.7	25.6	28.7
Nigeria	181.1	0.9	7.7
Sierra Leone	15.4	9.9	0.7
Togo	28.3	11.7	1.2
Asia/Oceania			
Malaysia	79.9	0.6	3.4
Papua New Guinea	54.5	6.1	2.3
Others	291.6	NA	12.5

[a] Does not include exports of semiprocessed cocoa products (for example, for Brazil, the largest cocoa products exporter earned an additional average $107 million annually during 1980-82).

25X1

World Cocoa Bean Production

Thousand metric tons

	Average 1975/76-1979/80	1980/81	1981/82	1982/83	1983/84	1984/85 [a]
World total	**1,505**	**1,685**	**1,725**	**1,542**	**1,529**	**1,807**
Ivory Coast	292	412	456	360	405	475
Brazil	277	351	315	339	308	375
Ghana	311	258	225	179	159	175
Nigeria	181	155	182	156	125	150
Malaysia	24	49	61	68	90	125
Cameroon	103	120	120	106	109	115
Ecuador	79	85	88	55	55	100
Others	238	255	278	279	278	292

[a] Estimated.

25X1

International Cocoa Agreement

The Third International Cocoa Agreement (ICCA) is due to expire at the end of September, but includes provisions for a 12-month extension. The third conference on a new agreement recently ended inconclusively in Geneva as representatives from 70 producing and consuming nations failed to agree on price stabilization measures and the use of export restrictions to supplement a buffer stock mechanism. [redacted]

Negotiated in 1980, the present agreement has failed in its basic objective of maintaining a price range of $1.06 to $1.46 per pound. Because of inadequate funding, buffer stock purchases ceased after the 1982/83 season. In addition, the agreement was hampered by the nonparticipation of the United States and the Ivory Coast—respectively the world's largest cocoa consumer and producer. As a result, prices during the life of the agreement have averaged about 98 cents per pound. [redacted]

Brazil reportedly is now lobbying for a special session of the organization's council to discuss reactivation of buffer stock purchases and an extension of the current agreement. It is expected to table its proposal at the 44th General Assembly of the Cocoa Producers Alliance on 27 May. [redacted] *at the ICCO Council meeting now slated for July, the current agreement will be extended for another year.* [redacted]

of incentives for growers has been the principal cause but Ghana's deteriorating economy and weak currency have led to smuggling—15,000 to 40,000 tons annually—into neighboring Ivory Coast and Togo. Cocoa experts estimate about 20,000 tons annually go unharvested because of low government procurement prices or deteriorate because of transportation problems. The government has taken steps to raise production to 300,000 tons by 1987. We believe that this target will be extremely difficult to achieve, although it does appear that annual production can return to the 200,000-ton plateau by 1990.

- Nigeria's cocoa sector has been in the doldrums as Lagos shifted its attention to petroleum as the primary means of generating foreign exchange. The government has recently sought to revitalize the cocoa sector by raising producer prices, subsidizing the purchase of chemical sprays, and attempting to reduce smuggling. We believe — because of political uncertainties and lack of consistent followthrough—that the best that can be hoped for through the end of the decade is to stabilize production at about 150,000 tons annually. 25X1

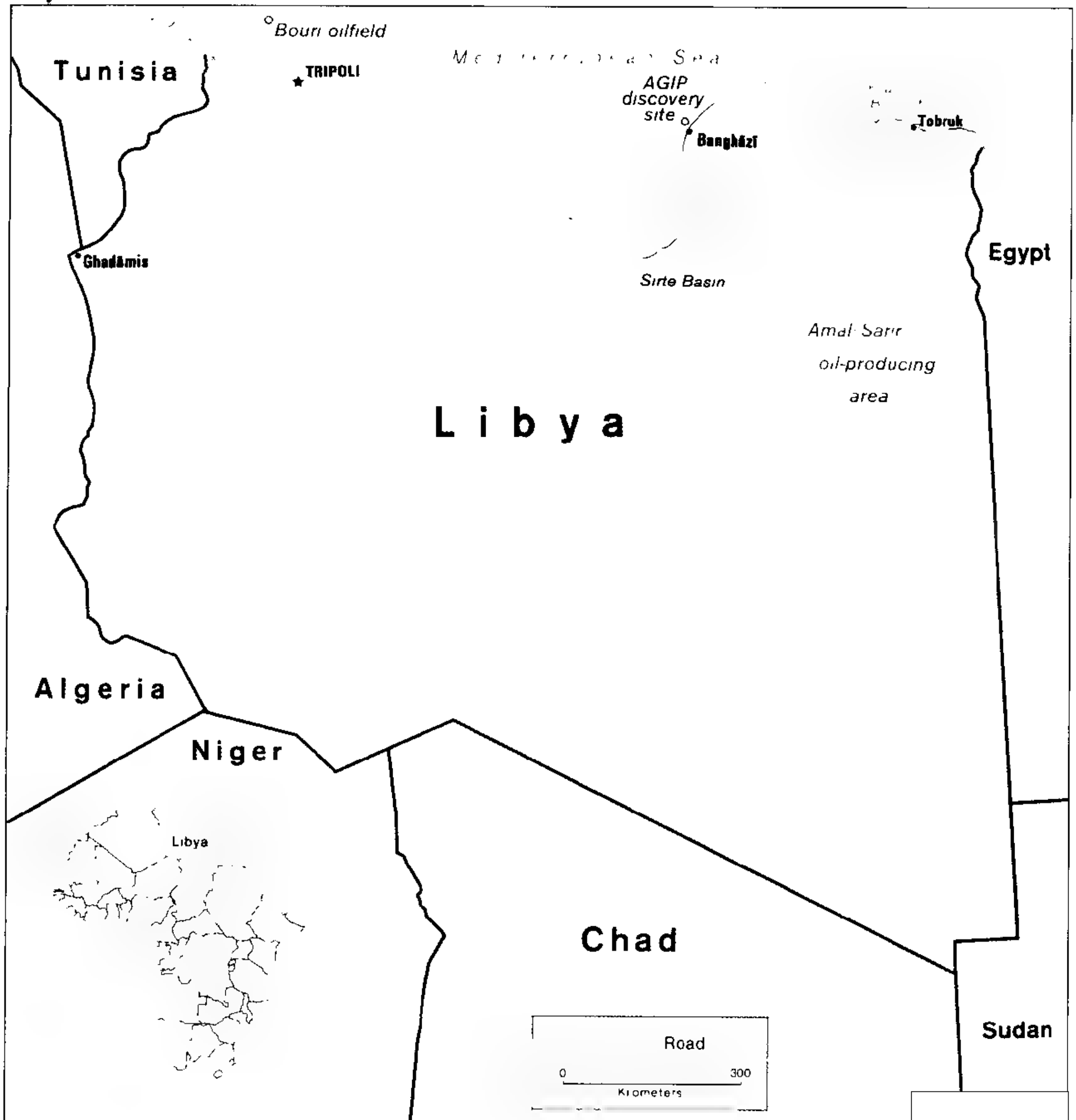
- Cameroon's annual cocoa production has been relatively stable. Although the government has strongly supported the cocoa sector, endemic disease problems limit production potential. Yields are also relatively low because a large percentage of the trees are past their peak production years. [redacted] 25X1 25X1

Outlook for Market Stability 25X1

The prospect exists that world cocoa production could significantly outpace consumption growth by the late 1980s resulting in considerable downward pressure on prices. The robust cocoa industries in Brazil, Malaysia, and the Ivory Coast appear more capable of weathering changing market conditions than most of the traditional West African cocoa producers. For the lagging West African producers—particularly those that depend heavily on cocoa export earnings—a price decline would hurt their debt servicing capabilities and put additional strains on their already, troubled economies. Producers are likely to increasingly look to an International Cocoa Agreement as a vehicle to aid in price stabilization and thereby avoid significant declines in cocoa earnings. We believe, however, that for individual producers the vitality of their earnings will depend not so much on a new ICCA, but on the success of efforts to improve production efficiencies and cocoa quality. [redacted] 25X1 25X1 25X1 25X1

[redacted] 25X1

Libya



705104 5-85

Briefs

13

Energy

25X1

Promising Libyan Oil Prospects

Despite budgetary cutbacks, Libya is maintaining an active oil and gas exploration program in promising onshore and offshore areas, [redacted] Major onshore finds are expected in the Amal-Sarir 25X1 area in eastern Libya, with lesser discoveries likely along the Algerian border. Offshore prospects include an area north of Tripoli near the large Bouri field and an area west of Banghazi where AGIP of Italy made a recent discovery. Drilling operations in the Khalij al Bumbah (Gulf of Bomba) west of Tobruk, however, have been unproductive. Last year 22 successful wells were drilled in 25X1 new fields with yields of 1,000 to 5,300 b/d, [redacted] Although Libyan companies are doing most of the drilling, Bulgarian, Romanian, Brazilian, West German, Italian, and American firms are also involved. 25X1 This new exploration could add significantly to Libya's proved reserves, estimated at about 22 billion barrels. [redacted]

25X1

Oil Market Weakness

Renewed oil market weakness in recent weeks reflects lower oil consumption and rising production worldwide. Spot prices for most OPEC crudes are now 50 cents to $1.00 below official prices. The USSR and Egypt lowered crude prices by $1.00 and 75 cents per barrel, respectively. Oil consumption in the major developed countries in the first quarter declined by 2 percent compared with year-earlier levels. Partial April data for the United States show a 5-percent drop in total sales. Despite declining consumption, we estimate total non-25X1 Communist production has risen 1 million b/d from winter levels. These factors are causing an unexpected sharp inventory buildup. US oil inventories during the last two weeks in April, for example, rose by 1.5 million b/d, far above the seasonal norm. Unless demand rebounds during the summer months, oil producers will have to limit production or face increasing downward price pressure. [redacted]

25X1

Ekofisk Gas Supply Threatened

According to the US Embassy, gas deliveries from Norway's Ekofisk field — which produced about 259,000 b/d of oil and half of Norway's gas in 1984 may be reduced by one-fifth to permit increased reinjection of associated gas 25X1 to halt production platform subsidence. Some production platforms in the field -Norway's oldest —have sunk as much as 2.5 meters. [redacted] 25X1 the platforms may become too dangerous to use in about three years. Increased reinjection would prove costly as equipment and new platforms would be required. The reinjection program may require up to 20 percent of production—which averaged 35 million cubic meters per day in 1984—to stabilize reservoir pressure, according to Embassy sources. Industry press reports that the field operator has warned its European 25X1

customers it may have to cut gas supplies next winter. We believe the shortfall could be made up with Statfjord gas scheduled to be available in January 1986. The operator has resubmitted a request to purchase some of Statfjord's associated gas. [redacted] 25X1

[redacted] 25X1

Record Omani Oil Production

Oman's oil production broke 500,000 b/d this month—80,000 b/d above the 1985 production target according to US Embassy sources in the Ministry of Petroleum and Minerals. Muscat has not publicly acknowledged this record output, fearing cuts in aid from neighboring oil producers. Oman, which is not a member of OPEC, relies on oil for virtually all of its export earnings and has compensated for declining prices by boosting production. Muscat reportedly 25X1 ordered producers to maximize production, hoping to sell the oil before prices decline further. [redacted] 25X1

Burma Reorganizes Energy Planning

Rangoon last month established a new Ministry of Energy—in large part to facilitate the development of natural gas reserves in the Gulf of Martaban. The new ministry includes the Myanma Oil Corporation—the state petroleum enterprise—and other energy-related entities formerly under the control of the Ministry of Heavy Industry. An energy planning unit also will be established, according to the US Embassy. Despite Rangoon's optimism, the development of the Martaban gas reserves which the government estimates at 110 billion 25X1 cubic meters—will require more Western capital and technology than it so far has been willing to accept. [redacted] 25X1

Oil Problems in Zambia

A nine-bank consortium, which had been financing about $200 million per year in Zambian oil imports, has suspended financing for Zambia's oil needs. As a result, available supplies—including some 2.2 million gallons of diesel fuel promised by South Africa—will only last for about four weeks, according to US Embassy reporting. The consortium has reached a tentative agreement

25X1

with Lusaka to reinstate the credits provided that Zambia reduces its arrearages, totaling some $14 million, by 31 May. If the Zambians are able to take advantage of this stopgap measure, they may avert a serious fuel crisis, although minor shortages and rationing are expected. Lusaka still faces the broader problem of implementing a workable austerity program to stem its rising foreign debt. [redacted] 25X1

International Finance

Mexico's Growing Debtor Activism

[redacted]

Financial troubles are prompting Mexico to show greater interest in a political dialogue between debtor and creditor nations. President de la Madrid and senior officials recently called for multilateral concessions from lenders to resolve the world debt problem; Mexico up to now has negotiated individually with international banks. Finance Minister Silva-Herzog, who has opposed the group approach, appears to be losing influence. [redacted] 25X1 25X1 25X1 Mexico, however, is probably more interested in increasing its leverage with creditors than with signaling support for a debtors' cartel. De la Madrid's concern about continued access to international credit probably will prevent Mexico from endorsing a radical solution. [redacted] 25X1 25X1

Sweden Forgives Tanzanian Debt

[redacted]

The Swedish Debt Fund has allocated $11 million for payment of Tanzanian debt to Swedish commercial firms, according to Embassy reports. The Swedish Export Credit Board—which has already settled some commercial claims against Dar es Salaam will receive about 80 percent of the money with the remainder paid directly to Swedish firms. Tanzanian firms already have paid some of their debt in shillings, but the Tanzanian Central Bank has been unable to secure the hard currency; Sweden has proposed that the Tanzanian currency be used for local health and education projects. This will enable Tanzania to avoid defaulting on Swedish loans. Nordic donors have refused Tanzanian requests for increased assistance because of Nyerere's recent strong criticism of developed countries and have warned that further criticism could adversely affect current assistance programs. Nyerere's comments could also damage his hopes for increased EC aid. [redacted] 25X1 25X1

Global and Regional Developments

25X1

[redacted]

[redacted]

25X1

Responses to French EUREKA Proposal

West European officials have been responding cautiously to the French proposal for an arrangement called EUREKA to coordinate West European technological efforts. Their concerns include uncertainty about its organizational and financial arrangements as well as its relationship to European participation in US research on SDI. West German Chancellor Kohl and some Cabinet members have reservations about the expense and bureaucracy involved in creating another European institution [redacted] Italian officials have praised the French proposal, but Rome continues to support European participation in the SDI research program. [redacted]

25X1 25X1 25X1 25X1 25X1

The French are modifying their proposal somewhat in hopes of enlisting firm European support. They no longer describe EUREKA as a new agency but merely as a collection of informal measures to increase cooperation in a wide range of new technologies. Paris claims EUREKA is a civil program and not a response to SDI, but it probably recognizes that other West European countries and French industry will be less interested if it does not encompass some of the technology that may accrue from cooperation with the SDI program. [redacted]

25X1

UNCTAD Meetings on Natural Rubber Ineffective

UNCTAD meetings on the International Natural Rubber Agreement (INRA) ended last week in Geneva with little progress made toward a new agreement. As a result, the existing INRA, scheduled to expire in October, will probably be extended when the International Natural Rubber Organization (INRO) meets next month in Kuala Lumpur. An extension will mean continued adherence to the current price range, which producing members argue is too low—rubber growers claim that profit margins have been squeezed by increasing raw material costs. Natural rubber prices this year are averaging 15 percent below last year's level and roughly 45 percent less than their 1980 peak. [redacted]

25X1 25X1

Latin Sugar Producers Look to Ethanol Exports

Several Latin American sugarcane producers envision a strong export market for ethanol produced from sugarcane as developed countries such as the United States and West Germany phase down their use of leaded fuel. Ethanol, like lead, can be used to increase octane in motor fuels. Ethanol

25X1

exports would provide an attractive alternative at a time when the sugar market has been experiencing low prices, global surpluses, and increased competition in developed markets from alternate sweeteners. Producers in Argentina, El Salvador, and Guatemala are trying to increase distillery capacity to meet the anticipated growth in demand. Ethanol exports are especially attractive now for sugar producers in countries participating in the Caribbean Basin Initiative because they can enter the United States duty free. During 1984 the United States imported, mainly from Brazil, more than 150 million gallons of ethanol, nearly triple the 1982 and 1983 levels. [redacted] 25X1

National Developments

Developed Countries

Tokyo Begins Summit Planning

[redacted]

In the wake of French criticism of the Bonn Economic Summit, Japanese officials—who have already begun preparations for the next summit—are concerned that President Mitterrand might not attend the Tokyo Summit next May. Prime Minister Nakasone hopes to mark the end of his foreign affairs performance with a successful summit and will probably seek assurance of Mitterrand's attendance when the two meet in Paris in July. Taking into account Mitterrand's complaint that recent summits have become a closed bureaucratic forum, Nakasone announced on 14 May that the Tokyo Summit should be conducted in a "more casual manner" and that declarations should be released in the form of "one or two sheets of paper." [redacted] 25X1 25X1

[redacted] 25X1 25X1

Declining Prospects for Japanese Computer Project

[redacted]

Budget cuts and personnel problems are close to hamstringing MITI's highly touted Fifth-Generation Computer Project. The project's budget allocations for 1985 are smaller than in 1984, and less than half of that projected in 1981. Moreover, earlier cuts have reduced overall project funding to only three-fourths of original projections. The scheduled rotation of researchers back to industry also is causing major disruptions, and [redacted] corporate participants are balking at sending replacements. The funding cuts will significantly reduce the chances for progress and may force the Trade Ministry to scale back research goals. In addition, research under the project's initial stage (1982-85) is not yet complete and requires portions of this year's budget. Industry probably will be required to send new researchers, but they are likely to be young and inexperienced and will need lengthy training. The wholesale personnel rotation leaves only the project's managers to do the training, further clouding the prospects that the project will make progress any time soon. [redacted] 25X1 25X1 25X1

25X1

West Germany Easing Labor Market Rigidity

Recent legislation will help to make the West German labor market more flexible. The new law reduces limitations on job sharing and part-time work and relaxes the requirement that firms planning layoffs draw up compensation plans for the personnel to be dismissed—new firms, for example, are exempt. The legislation, however, was weakened by provisions that tighten restrictions on layoffs of construction workers and liberalize free visits to health spas. A companion bill, which is expected to be approved by the Bundestag, will lift some limitations on the employment of women and teenagers and widen employer discretion in setting working hours. Despite these positive moves, further progress will be difficult. A recent Free Democratic Party proposal that unemployed workers be allowed to work in union jobs for about 80 percent of the negotiated wage level was lambasted not only by the opposition and labor as an intrusion on collective bargaining, but even by some employers concerned with maintaining labor peace. 25X1 25X1

Growing Criticism of Thatcher

Prime Minister Thatcher, although in no danger of being ousted from power, is coming under growing criticism for her economic policies. Press reports say the bulk of the criticism concerns unemployment—now at 13.1 percent and rising and is coming from hitherto supportive sections of the Conservative Party. They are, however, stressing publicly that there is no consensus in the party's national leadership on an alternative to Thatcher or her policies. The government reportedly is also losing grassroots support. A nationwide poll shows a majority of Britons believe the nation is economically more divided and politically more polarized under Thatcher. 25X1 25X1

The criticism among senior Tories suggests a growing temptation to disassociate the party from Thatcher on unemployment. Although this is unlikely to impair Thatcher's ability to govern, her leadership of the party may be challenged before the next general election, due by 1988. She does not appear worried about her party's prospects in the next general election, even though the Tories have suffered losses in the balloting for municipal posts this week. 25X1

Britain Plans Cuts in Social Welfare

The Thatcher government is expected to release a green paper within the next few weeks that will outline its recommendations for reducing welfare spending measures that will save relatively little in the short run, but promise a greater impact in later years. According to the US Embassy, there is Cabinet consensus on eliminating maternity and death benefits, as well as Christmas bonuses paid to the elderly and raising the eligibility threshold for housing allowances. The most controversial proposal is to phase out the State Earnings-Related Pension Scheme (SERPS), a heavily subsidized program created by the Labor government in 1978 to supplement the flat-rate universal pension. The government estimates that expenditures for SERPS, although small at present, would escalate dramatically by the late 1990s as more pensioners qualified for benefits. London has not yet divulged the details of its alternative to SERPS, but it almost certainly will call for the expansion of private-sector 25X1

pension plans. Reductions in welfare expenditures will undoubtedly cost Thatcher popular support and will provide the opposition with specific issues to criticize. [redacted] 25X1

Australian Financial Woes

During the last three weeks the Australian dollar, which had fallen 27 percent this year to a low of 63 US cents on 22 April, has rallied to about 69 US cents. The rally is due in part to decisive steps taken by Prime Minister Hawke on 22 April: he pledged to cut next year's budget deficit by US $700 million and Energy Minister Evans refused to subsidize domestic oil prices. In addition, currency traders apparently were encouraged by two consecutive months of marginal improvement in the balance of trade and by the lack of response in Queensland to calls for statewide strikes. Nevertheless, with a debt service to exports ratio of 42 percent for fiscal 1984, a widening current account deficit, 25X1 and a budget deficit almost 4 percent of GDP, we believe Australia will continue to worry investors, currency traders, and bankers. Australia's total foreign debt—most of it private—will probably reach a record of US $50 billion for the year ending in June—28 percent of GDP. At the same time, the current account deficit is likely to hit US $7 billion—also a record. Moreover, monetary growth—now running close to 14 percent—and higher import costs resulting from devaluation will spur inflation, now about 7 percent at an annual rate. As a result, wages, which are indexed to inflation, would rise further, undermining Australian competitiveness. [redacted] 25X1

Less Developed Countries

Brazil's Emerging Fiscal Strategy

Finance Minister Dornelles and his anti-inflation prescriptions are gaining support from President Sarney at the expense of rival Planning Minister 25X1 Sayad, an advocate of expansionary policies, [redacted] With Sarney's approval, Dornelles told the Brazilian Congress last 25X1 week the administration intends to reduce substantially a $17 billion public deficit it inherited this year. The administration recently approved a $2.5 billion social program proposed by Sayad but expects to more than offset its economic impact with deep cuts in subsidies and other spending. The boost in 25X1 Dornelles' influence probably reflects recent success in reducing inflation and improves prospects, at least temporarily, for stabilization policies. A major task Dornelles now faces will be to marshal support for fiscal austerity from an increasingly assertive Congress, probably using increased social spending to 25X1 co-opt left-of-center members. [redacted]

Brazil Increases Wheat Support Price

Brazil recently announced a 267-percent increase in the minimum purchase price for the 1985 wheat crop. Set at about $225 per ton and pegged to the value of the cruzeiro, the new purchase price should boost wheat-planted area by 25X1 16 percent, yielding a crop of 2 million metric tons, [redacted] Combined with an expected decline in domestic wheat consumption 25X1

25X1

as the consumer price subsidy is phased out, wheat imports this year could be pared by 500,000 tons to about 4.4 million tons. Reducing its wheat import bill—$755 million in 1984 and second only to oil—is a priority goal of the new government. [redacted] 25X1

Brazil To Cut Sugar Production

[redacted]

Brazil, the world's largest sugarcane producer, plans to cut cane sugar production in 1985/86 (June/May) to 7.9 million, down 1 million tons from this season's total. According to Brazil's Sugar and Alcohol Institute (IAA), the planned reduction reflects depressed world sugar prices. About 2.5 million tons of the coming crop is expected to be exported, earning about $500 million, compared with earnings of over $1 billion from sugar in 1981 and 1982. IAA officials also stated that more sugarcane will be converted to ethanol during 1985/86 for Brazil's growing fleet of alcohol-powered cars. [redacted] 25X1 25X1

Chile's Worsening Trade Accounts

[redacted]

A declining trade surplus could bloat Chile's current account deficit to $1.8 billion some 30 percent above its 1985 IMF target—forcing corrective action to prevent serious cash strains later this year. Chile's first-quarter trade surplus was $170 million—down from $227 million in the same period last year. Exports fell 5.3 percent to $921 million, because of a drop in copper and industrial product exports. Meanwhile, imports rose less than 1 percent to $750 million, because, the US Embassy reports, Chilean businessmen, fearing a devaluation and tariff increases, rushed to stockpile intermediate and capital goods imports. [redacted] the declining trade surplus sparked increased capital flight. To shore up the external accounts, we believe the new economic team will devalue the peso before the end of June, and impose a differentiated tariff system—applying higher tariffs on goods not used in producing exports. Additionally, Santiago may resort to import barriers. [redacted] 25X1 25X1 25X1

Nicaragua Offered Merchant Ships

[redacted]

[redacted] the National Bank of Spain has agreed to sell two 5,000-ton general cargo ships to a joint venture formed by a Spanish national and a US company; the buyers have offered to resell the ships to Nicaragua for $4 million. The buyers expect to register the ships in Panama early this month and will offer to operate the ships for Nicaragua, probably to carry cargo between Eastern Europe and Nicaragua. The Spanish bank may not be aware of the final purchaser of these ships. Registering the ships under the Panamanian flag avoids open Nicaraguan ownership, but the US embargo nevertheless may complicate the joint venture's negotiations. Nicaragua's fleet currently is composed of coastal freighters and only one oceangoing freighter; the two ships would add substantially to its total shipping capacity. [redacted] 25X1 25X1 25X1

Sudanese-Libyan Economic Rapprochement

Recent efforts to restore diplomatic ties between Khartoum and the Qadhafi regime may bring some economic relief to financially strapped Sudan. The US Embassy in Khartoum says that, under recently signed agreements, Libya has promised a three-month supply of crude oil, 100,000 metric tons of wheat and transport trucks, crop-dusting aircraft and expertise, as well as medical supplies. Tripoli also claims to have stopped aid to Sudanese opposition groups. Sudan has stopped anti-Qadhafi radiobroadcasts and terminated all support for Libyan opposition activities as their part of the deal. Libyan calls for a union similar to the Morocco-Libya union, however, appear to have fallen on deaf ears in Khartoum. On the surface, the new Sudanese regime has kept Libya at bay and may have gained some badly needed aid, but the new agreement also enhances Qadhafi's ability to exploit weaknesses in the new regime from within. Qadhafi's aid offer is a typical ploy to establish relations, however, his record weighs against large-scale disbursements

25X1

25X1

South Yemen's Economic Decline

South Yemen is facing serious economic problems that will force it to abandon some development projects, slow down others, and make draconian cuts in imports. The continuing drought has seriously damaged agricultural production—necessitating an increase in food imports. Meanwhile, debt repayments and reduced foreign aid are squeezing limited foreign exchange reserves. Gulf Arab states and Libya have not provided expected aid, and Soviet Bloc nations have failed to take up the slack. Aden has ordered a 50-percent cut in imports from last year's level, including elimination of all luxury imports. Opponents of pragmatic President Ali Nasir Muhammad probably will raise the economy as an issue in October's party congress.

25X1

25X1

25X1

Record Stocks Spur Indian Wheat Exports

Despite poor weather, we expect India's 1985 spring wheat crop to approach last year's record production, which will add to the government's severe storage problems and spur renewed efforts to find export markets. Increased irrigation, high-yielding varieties, and a dramatic rise in fertilizer use are likely to boost total foodgrain output for 1984/85 (July/June) to about 150 million metric tons. Two bumper crops of wheat and rice have created major storage problems which, according to press and Embassy reports, have forced the government to consider increases in food-based welfare programs and to seek export markets for about 4 million tons of wheat. India already has commitments for nearly 1 million tons of wheat from the USSR, Romania, and the World Food Program. Additional sales will be difficult—the world wheat market is glutted, Indian wheat quality is uncertain, its port facilities are inadequate, and its domestic prices are relatively high. New Delhi will likely combat these disadvantages by offering a combination of low-transport rates, subsidies, or barter arrangements.

25X1

25X1

12

Indonesia Attacks Its High-Cost Economy

[redacted]

With the soft oil market putting stiff pressure on Jakarta to improve the competitiveness of its nonoil exports, the government is shifting its focus from monetary and fiscal policy to cutting production costs in specific sectors. President Soeharto last month dismissed the director general of the notoriously corrupt Customs Service and appointed Finance Minister Prawiro and Armed Forces Commander Murdani to oversee a thorough cleanup of Indonesia's customs and port procedures, a move that would achieve significant savings because more than 80 percent of imports are capital and intermediate goods. According to the US Embassy, many observers expect additional reforms in the land transport and telecommunications sectors. Prospects for achieving a major boost in competitiveness are still doubtful, however, because some officials, such as the new head of the government body responsible for overseeing foreign investment, favor continuing protection for high-cost firms. [redacted] 25X1

25X1

Brunei Royalty Impedes Foreign Firms' Operations

[redacted]

Since Brunei gained independence last year, the royal family—to increase its personal wealth—has created obstacles to the operation of foreign firms. [redacted] 25X1 [redacted] the royal family plans to take over its offshore petroleum concession—which covers 40 percent of Brunei's continental shelf—by delaying exploration efforts. 25X1 Unsuccessful thus far, the firm must find oil in the next two years to maintain its contract. Last month, officials of a US construction corporation were detained by police for questioning and their local partner jailed at the instigation of another royal family member. In addition, the chief executive officer of Brunei Shell Petroleum—a 50-50 joint venture between Royal Dutch Shell and the Brunei Government—recently had two raucous confrontations with a high-level family member. 25X1 We believe that pressures on foreign firms are likely to increase as factions within the royal family become more competitive. [redacted] 25X1

Taiwan's Economic Reform Committee

[redacted]

Taipei has established a committee to recommend policy changes to boost Taiwan's sagging economy. Formed on the recommendation of Premier Yu Kuo-hua, the committee consists of government, academic, and business leaders, including proponents of economic liberalization who have long opposed Yu's conservative policies. The committee will have six months to formulate its recommendations. Yu may have suggested the committee to bolster investor confidence weakened by a stagnant domestic economy, declining trade levels, and recent financial scandals. The government has loosened some restrictions on trade and investment—largely in response to US pressure—but retains measures that protect domestic industry. 25X1 Yu probably will continue to resist liberalization, however, and may be gambling that the economy will recover by the time the committee concludes its study [redacted] 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

Communist

China's Shrinking Grain Imports

Beijing has purchased only 2 million metric tons of grain this year, and grain traders are predicting that China may import as little as 5 million tons in 1985—1984 imports totaled 9.7 million tons. All major suppliers are affected, particularly the United States, which generally accounts for half of China's grain imports. China has not purchased any US grain this year and is likely to import 2.5 million tons of US grain, at most, by yearend. In fact, China may be a net grain exporter for the first time this year—Beijing recently signed a one-year agreement to export 1.5-2.0 million tons of corn to Japan. This situation is unlikely to continue, however, because Beijing is both reducing government grain purchases and boosting livestock production. 25X1

25X1

25X1

25X1

Page Denied

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000807530001-9